No. 13,503

IN THE

United States Court of Appeals

For the Ninth Circuit

GIULIO PARTICELLI,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ESTATE OF ELETTA PARTICELLI, Deceased,
Arthur Guerrazzi, Executor,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Review of The Tax Court of the United States.

SUPPLEMENTAL BRIEF OF PETITIONERS.

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INTRODUCTORY.

This case is set for argument on April 7, 1954, and the final brief was filed on April 17, 1953. In the interim, several court decisions have been rendered which bear directly on the issues and should be called to the attention of the Court. This supplemental brief is offered for that purpose.

We shall discuss these intervening decisions in the order of their significance on the issues herein, not necessarily in the order in which the points involved were discussed in the earlier briefs.

I. TAX CONSEQUENCES OF CONTRACTS ARE TO BE DECIDED ON THE BASIS OF THE TERMS OF THE CONTRACTS, NOT ON THE BASIS OF THE CIRCUMSTANCES LEADING UP TO THE CONTRACTS.

The decisions in *Hamlin Trust v. Commissioner,* (CA 10, Feb. 1, 1954) 54-1 USTC 9215, not yet officially reported, affirming 19 T.C. 718, and *Commissioner v. Gazette Tel. Co.,* (CA 10, Jan. 30, 1954) 54-1 USTC 9214, not yet officially reported, affirming 19 T.C. 692, are essentially in conflict with decision below herein, yet in them the Tax Court took, and the appellate court affirmed, a position contrary to the position the Tax Court took herein. Perhaps this inconsistency is explained by the fact that the *Hamlin Trust* and the *Gazette* cases were reviewed by the full Tax Court, whereas the instant case was not.

The facts in the *Hamlin Trust* and the *Gazette* cases are fully set forth in 19 T.C. 718, and are summarized in the opinions of the appellate court. They show that, just as in the instant case, an offer was made and informally accepted for the purchase and sale of property for a lump sum price. It was understood that for that price the sellers were to transfer title to stock and give a covenant not to compete. When the parties met to draw up a formal contract, the sellers presented

a draft contract providing for a lump sum consideration. The purchasers asked that the draft be changed to allocate $150 per share to the stock and $50 per share to the covenant not to compete, for the purposes of making the covenant enforceable and of helping them taxwise. The sellers thought the allocation made no difference to them so they agreed to it with little discussion.

The Tax Court refused to permit either the Commissioner or the sellers to disregard the allocation in the contract. In the *Hamlin Trust* case, where the sellers were seeking to do this, the three dissenters in the Tax Court said (19 T.C. at 726):

> "Recitals of a written instrument as to the consideration are not conclusive and it is always competent to show by parol or other extrinsic evidence what the real consideration was. *Haverty Realty & Investment Co.,* 3 T.C. 161. Tax consequences from the sale of property depend upon the substance and actuality of the transaction rather than the form or recited consideration in the contract. *Commissioner v. Court Holding Co.,* 324 U.S. 331. As was said by the Supreme Court in this case: "* * * To permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress."

Parenthetically, it should be noted that the opinion below in the instant case uses the same quotation for the same point (R. 71) and cites *Haverty Realty & Investment Co.,* 3 T.C. 161, in exactly the same way (R. 77).

The Court of Appeals disagreed with the dissenters and affirmed the Tax Court in each case. Its opinion in the *Hamlin Trust* case is the more detailed and is the one referred to in the next remarks. In reaching its conclusion that the tax consequences of a contract at arm's length must be determined by its terms and not by superseded negotiations, the appellate court first concluded that the issue before it was one of law. It then rejected the contention that the contractual allocation should be upset because it had been made with very little discussion and without equal interest of both parties, using the following language:

> "It is true that there was very little discussion of the suggested allocation. But the effectiveness tax-wise of an agreement is not measured by the amount of preliminary discussion had respecting it. It is enough if parties understand the contract and understandingly enter into it. The proposed change in the contract was clear. All parties participating in the conference agreed to it. The owners of stock present signed the written contract at the time and others signed it later. It is reasonably clear that the sellers failed to give consideration to the tax consequences of the provision, but where parties enter into an agreement with a clear understanding of its substance and content, they cannot be heard to say later that they overlooked possible tax consequences. While acting at arm's length and understandingly, the taxpayers agreed without condition or qualification that the money received should be on the basis of $150 per share for the stock and $50 per share for the agreement not to compete. Having thus agreed, the taxpayers are not at liberty to

> say that such was not the substance and reality of the transaction."

We submit that the rule cuts both ways; the Commissioner is also bound by it.

Two intervening decisions by the Court of Appeals for the Seventh Circuit go beyond our position. In *Consolidated Apparel Co. v. Commissioner,* (CA 7, Oct. 23, 1953) 207 F. 2d 580, reversing 17 T.C. 1570, the appellate court enforced a novation between related parties because the rentals provided therein were reasonable. It said (207 F. 2d at 583):

> "But before a court can declare a contract to be a collusive subterfuge, there must be evidence to sustain that finding, or its equivalent."

It found no such evidence in the case before it, since the parties lived up to the contract in their conduct. In the second case (*Commissioner v. Oates,* (CA 7, Nov. 3, 1953) 207 F. 2d 711, affirming 18 T.C. 570), both the appellate court and the Tax Court agreed that the Commissioner was bound by a novation between unrelated parties, even though made to accommodate the taxpayer.

It is apparent that if the Commissioner is bound by a novation, even where made between related parties, then he certainly has no power to substitute a preliminary agreement for the later formal contract which the parties intended should supersede it, as he seeks to do here. And if there be a requirement even between unrelated parties, as the Seventh Circuit held there was between related parties, that the formal contractual terms be reasonable,

then petitioners' case can meet that test. Certainly it cannot be said that the sale of wine for the ceiling price is unreasonable.*

The Sixth Circuit has also had to reverse the Tax Court for refusing to give tax effect to contracts. In *Nelson v. Commissioner,* (CA 6, April 11, 1953) 203 F. 2d 1, this was done, the appellate court saying (203 F. 2d at 7):

> "In a free economy, courts are not permitted to make contracts for the parties, but merely to pass upon the legality of such contracts when made."

We submit that that admonition is controlling here.

II. THIS COURT HAS JURISDICTION TO DISREGARD FINDINGS OF FACT OF THE TAX COURT WHICH DISREGARD OR MISUNDERSTAND EVIDENCE IN THE RECORD.

Respondent seems to contend (Resp. Br. 20-22) that this Court is powerless to consider the merits of this appeal because of the findings of fact below. Two intevening decisions, one of which is from this Court, dispose of that contention.

In *Gensinger v. Commissioner,* (CA 9, Nov. 30, 1953) 208 F. 2d 576, this Court held that it was not bound by the Tax Court's findings as to the taxpayer's intent, and

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*In this connection, see *Albert T. Felix,* 21 T.C. No. 90, CCH Dec. 20,178, promulgated Feb. 26, 1954, a reviewed case, where the Tax Court sustained a sale and lease-back at OPA ceiling prices between related parties, saying:

> "The sale and lease arrangements between the trustee and the petitioners appear to have been entered into in good faith. The equipment was sold to the trust and leased back at prices fixed by the OPA, and so must be regarded as fair and reasonable."

reached a conclusion on that point contrary to that which the Tax Court had reached. In the instant case, the decision below can be sustained only if the Court rejects our contentions that the Tax Court erred in its conclusion that the formal contract did not express the parties' real intent. We have challenged this conclusion both as a matter of law and of fact. The *Gensinger* case supports our contention that after giving effect to the Tax Court's findings on basic facts as to which there was conflict in the evidence, this Court has jurisdiction to decide that those findings and the other facts as to which there was no conflict establish that the ultimate conclusion below as to intent was clearly erroneous.

Beamsley v. Commissioner, (CA 7, July 31, 1953), 205 F. 2d 743, is to the same effect. There too the Tax Court had disregarded the terms of a written contract, and had based a decision on ultimate findings of intent contrary to the terms of the contract. (18 T.C. 988.) In reversing, the appellate court reviewed the evidence, referring to much of that relied on below as "window-dressing." (205 F. 2d at 745.) It dismissed the finding, that the consideration paid was for something different than the contract said it was, as being based "upon speculation and conjecture." (205 F. 2d at 750.)

We submit that these cases hold a lesson applicable here. The evidence relied on here to disregard the contract notwithstanding the fact that the parties lived up to its terms in their conduct after it was signed, is quite as flimsy as that in the *Beamsley* case. Here too actual conduct was cast aside and the case was decided on speculation and conjecture.

III. IN ANY EVENT, REVERSIBLE ERROR OCCURRED AT THE TRIAL IN THE ADMISSION OF EVIDENCE OF A CRIME OF WHICH PETITIONER HAD NOT BEEN CONVICTED.

On November 17, 1952, this Court decided *Wolcher v. United States,* 200 F. 2d 493. We are not able to state at this time whether or not that case had been reported in the advance sheets when our earlier briefs were being written, but our research tools did not bring it to light until later. It is of such importance on this issue that we would necessarily refer to it in oral argument, and we conceive that it would be helpful to the Court if we should discuss it in this supplemental brief.

The *Wolcher* case was a criminal case in which a conviction was reversed because of the admission of evidence tending to establish that the defendant was guilty of another crime, of which he had never been convicted. The evidence was not offered for purposes of impeachment but as evidence supposedly bearing on the question of guilt of the crime charged. This is substantially the explanation respondent gives in support of the admissibility of similar evidence in the instant case (Resp. Br. 38, footn.; Pet. Reply Br. 2). The opinion of this Court explaining why the admission of the evidence was reversible error is as illuminating a discussion of the law as we have ever read, and therefore we set it forth in extenso (200 F. 2d at 497-498):

> "When there is proof that an act has been done and the question arises whether it was done with criminal intent, other similar acts by the accused may be proven for the purpose of demonstrating that he was acting at the time alleged in the indict-

ment with criminal intent and volition. In such cases the fact that the prior acts may themselves be criminal in character does not exclude them.

"At the same time we must bear in mind that the commission of a wrongful act charged cannot ordinarily be established by proof that the defendant has previously committed other wrongful acts. It is fundamental that such a method of proof is inadmissible merely for the purpose of showing that the defendant has a generally criminal disposition or character. Hence, if in order to prove intent, evidence is to be received of other wrongful acts, the acts thus proven must be of such character that as a matter of logic they tend to demonstrate a criminal intent at the time of the commission of the act now charged. For one thing the prior acts must be similar to the one now charged.

"The caution which the courts must exercise in such cases is well set forth in Boyer v. United States, 76 U.S. App. D.C. 397, 132 F. 2d 12, 13. In that case, while the prior act proven was similar to that charged, the receipt of the proof of the prior act was held to be error because it occurred nearly two years before the date charged in the indictment. The general rule, relating to admission or exclusion of evidence of such acts was stated as follows in 132 F. 2d at page 13: 'In various circumstances, therefore, evidence of earlier acts good or bad may be admitted, as tending in one way or another to show a man's state of mind, when he is charged with a later fraud. But the fact that intent is in issue is not enough to let in evidence of similar acts, unless they are "so connected with the offense charged in point of time and circumstances as to throw light upon the intent." '

"In the case before us the circumstances relating to the preliminary draft of the partnership return were in no way connected 'in point of circumstances' with the offense charged in the indictment. The only resemblance between the two sets of acts would be that both had to do with tax returns. But the partnership return was of an entirely different nature from the transaction for which the defendant was here on trial. The evidence relating to the partnership was not logically relevant either to prove or disprove the intent or knowledge of Wolcher in connection with his performance of the acts shown at the trial and charged in the indictment.

* * * * * * *

"The jury * * * were * * * permitted to infer defendant's guilt from the fact of a prior unrelated, dissimilar wrongful act. As stated in Boyer v. United States, supra, 132 F. 2d at page 13, 'No doubt the alleged fact that a man committed a crime on another occasion tends to show a disposition to commit similar crimes. But when the prior crime has no other relevance than that, it is inadmissible. Its tendency to create hostility, surprise, and confusion of issues is thought to outweigh its probative value. The law seeks "a convenient balance between the necessity of obtaining proof and the danger of unfair prejudice." *The alleged fact that a man committed one forgery clearly increases the likelihood that he committed another forgery, but testimony to the earlier crime is not, for that reason alone, admissible.*' We hold that it was error to admit the working copy of the Gold Coast partnership return in evidence." (Emphasis ours.)

The agreement expressed with the District of Columbia case of *Boyer v. United States,* 132 F. 2d 12, is also notable. It is evident that the *Wolcher* case applies the rule prevalent in the District of Columbia, which the courts in that jurisdiction apply in civil cases as well as in criminal cases. (Pet. Op. Br. p. 15.) Since the Tax Court is bound to apply the rules of evidence in effect in the District of Columbia, it committed reversible error in admitting the evidence of unconvicted crime, whether it was for purposes of impeachment as trial counsel for respondent said, or to establish a substantive fact, as his brief here argues.

CONCLUSION.

The judgment of the Tax Court should be reversed.

Dated, San Francisco, California,
March 23, 1954.

Respectfully submitted,
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